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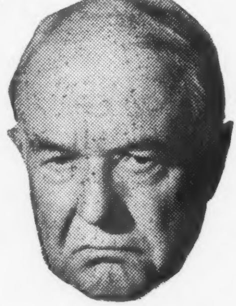
"I'll tell you
GOOD TIMES ARE
COMING!"



"I'll tell you
BAD TIMES
AHEAD!"

What's it to you?—PLENTY!

OKAY! Maybe the optimists are right. There'll be good times after the war.

OKAY! Maybe the pessimists are right. We'll have another depression.

What's it to you? PLENTY! It's largely in *your* hands as to which we'll have.

The one way to make it *good times* is to do your share to help keep prices down now!

That means *buying only what you really need*. It means *paying off your debts, saving your money*.

And here's where you're lucky. The same program that helps insure prosperity is also the best possible way to get yourself in shape to take another depression if one does come. So what? *You're right both ways*—if you save your money. *You lose both ways*—if you splurge right now.

Think it over, fella. Then get in there and fight. Read—and observe—the four rules to head off inflation. The war isn't over yet. And the war against *inflation* isn't over yet—by a long shot. Remember World War I? The cost of living rose twice as fast *after* the war as it did during the war itself.

4 THINGS TO DO to keep prices down and help avoid another depression

1. Buy only what you really need.

2. When you buy, pay no more than ceiling prices. Pay your ration points in full.

3. Keep your *own* prices down. Don't take advantage of war conditions to ask more for your labor, your services, or the goods you sell.

4. *Save.* Buy and hold all the War Bonds you can afford — to help pay for the war and insure your future. Keep up your insurance.

HELP US KEEP PRICES DOWN

A United States War message prepared by the War Advertising Council; approved by the Office of War Information; and contributed by this magazine in cooperation with the Magazine Publishers of America.

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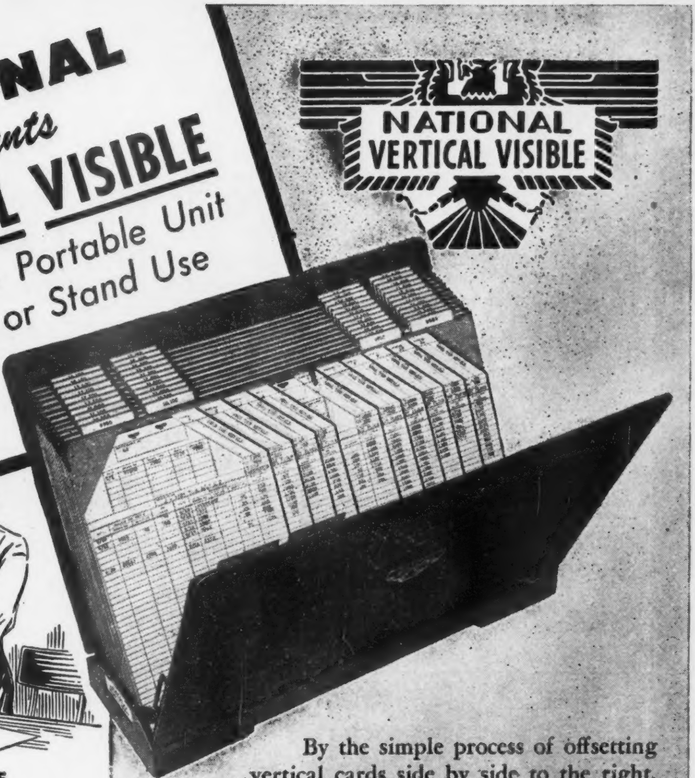

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Announcement of

1945 PRIZE ESSAY CONTEST

The Board of Directors of the Society has authorized the Committee on Publications to conduct a prize essay contest, the essays to be on a subject of interest to the accounting profession and suitable for publication in The New York Certified Public Accountant. Prizes in the amount of $150 for first prize, $100 for second prize, and $50 for third prize are offered.

The general rules of the contest are as follows:

All papers shall be original and the manuscript shall be typed in duplicate on 8½ x 11 stationery, double or triple space typing, and should not be more than 5000 words.

★

The name of the individual submitting the paper should not appear thereon, nor should there be any other means of identifying the manuscript, which should be accompanied by a covering letter giving the contestant's name and address.

★

When submitted to the judges, each manuscript will be given a key number of identification.

★

Manuscripts should be forwarded to The Managing Editor of The New York Certified Public Accountant, 15 East 41st Street, New York 17, N. Y., on or before May 1, 1945. Awards will be announced as soon thereafter as possible.

★

All papers submitted shall become the property of the New York State Society of Certified Public Accountants and shall be available for publication in The New York Certified Public Accountant. The decision of the judges shall be final as to what papers may be entitled to prizes.

THE NEW YORK CERTIFIED PUBLIC ACCOUNTANT

The matter contained in this publication, unless otherwise stated, are the statements and opinions of the authors of the articles, and are not promulgations by the Society.

VOL. XV *January • 1945* NO. 1

A Message from the President To the Members

THE year 1945 opens somberly. We had believed that the European struggle could be ended last year. Now we know that the hardest fighting and our greatest losses lie ahead.

We know also that our greatest opportunities to live grandly lie ahead. Resolute courage and uncomplaining endurance can give a glory to the severest sacrifice. History may say of 1945 in our United States, as of 1940 in Britain—"This was their finest hour."

We are a united people—united against a savage assault on all that makes men different from brutes, on all that we think of as civilization. This conflict is, basically, a contest between animalism and spirituality.

Through the long centuries since God called Abraham to come out from the land of his fathers and to serve Him; since Peter the Fisherman founded that great and venerable church at Rome on his belief in the life and works of Jesus the Jew; and since, four hundred years ago, those who ardently believed in the separate and individual sanctity of the human spirit in each and every man formed societies devoted to the expression of that belief—mankind has struggled upward, out of brutality and into the likeness of Sons of God.

Now the forces of evil have attacked all the precious fruitage of all those years. God helping us we can do no other than oppose those evil forces with all that we have of body, mind and soul.

Our Society is a united group of professional brothers. "What e'er our name or sign" we all accept the words of the prophet Micah—

> "He hath showed thee, O man, what is good; and what doth the Lord require of thee, but to do justly, and to love mercy, and to walk humbly with thy God?"

We all accept the summary of God's law made by a later prophet, Jesus of Nazareth—

> "Hear, O Israel; The Lord our God is one Lord: And thou shalt love the Lord thy God with all they heart, and with all thy soul, and all thy mind, and with all thy strength: and thou shalt love thy neighbor as thyself."

The foundation of our practice as professional men is the Justice and Truth that shines forth in every expression of religious life. Traditionally—and in fact—we are not "special pleaders." We tell the truth.

With clear conscience and firm resolve we can face the coming bitter year:

> Then conquer we must,
> When our cause it is just,
> And this be our motto,
> "In God is our Trust!"

HENRY A. HORNE,
President.

January 1, 1945.

Administration of the Federal Income Tax

By Norman D. Cann

Introduction

I HAVE been honored with an invitation to talk to this group about the "Administration of the Federal Income Tax." This is a particularly appropriate group for such a discussion. You are by training and experience familiar with the many problems of the income tax,—problems that are very often more in the nature of accounting jobs than legal questions.

Your officers have been kind enough to suggest certain specific problems which might be of interest, and I intend to cover those points. However, I hope you will bear with me for a few moments while I digress on some of the broader aspects of income tax administration.

We in the Bureau of Internal Revenue are today collecting income and excess profits taxes at the rate of $35,000,000,000 per year. In addition, we collect more than $5,000,000,000 of other revenues. That, I know you will agree, makes us the biggest business organization in the world.

In one sense, the collection of these vast sums is a great achievement—one well worth considering when attention is drawn to some of our inevitable shortcomings.

But in another sense, these collections also represent a great responsibility. Such sums cannot safely be withdrawn from our economy without attention to equity and law. If we seem a little slow and cautious in deciding questions at times, I beg of you to remember how important it is for us to avoid, as nearly as humanly possible, hasty and ill-considered action which may cause great injury to many people or endanger the war-time revenues of our nation.

Permit me to give you a striking example. Under Section 722 of the Internal Revenue Code, the Bureau faces requests for refunds of excess profits tax totalling possibly $12,000,000,000. Shall we deny all these requests because it is too much trouble and takes too much time to weed out the worthy from the unworthy claims? Or shall we close our eyes to the obvious intent of the revenue laws and pay all the claims, no questions asked?

Norman D. Cann, author of **Administration of the Federal Income Tax,** is Deputy Commissioner of Internal Revenue.

Presented at the November 27, 1944 meeting of the Society.

I think this audience will appreciate the sanity of our plans to examine these claims fairly and thoroughly—no matter what the effort and the time—and to pay the meritorious claims and deny the others. This, I believe, is the essence of good tax administration.

Our attitude toward Section 722 is typical of our attitude toward other income tax problems. As much as you practitioners, and as much as the public, we too desire speed and simplicity. There are many things we have done and are doing to speed up decisions. Take for example the decision this summer to authorize our agents in the field to rule on pension trust cases. This action should make possible the issuance of rulings by December 31 on all of the more than 5,400 pension and profit-sharing plans which have been filed to date. We have cooperated heartily in the simplification of the individual income tax, and if you have examined the return forms for 1944 I know you will agree that great steps have been taken to make individual returns more understandable and simple to fill out.

Yes, we want speed and simplicity, but none of us want these things at the price of arbitrary and discriminatory action. That means that, often, we must take time to be careful. In these days when more than 5,000 of the Bureau's trained men are in the armed services and experienced help is hard to recruit, allowance must be made too for a shortage of qualified personnel.

You practitioners, I know, have your problems, too. Which brings me to the point—which is to tell you how much we appreciate and depend upon your patience and cooperation.

Now, with your permission, I think that I had better get down to the specific points upon which I was asked to speak.

These points were as follows:

1. Administrative practice with respect to depreciation.
2. Policy in connection with salary deductions.
3. Problems relating to applications for changes in taxable years.
4. Policy in applying pension trust rulings retroactively.
5. Attitude toward family partnerships.
6. Speeding up of refund procedure in carry-back cases.
7. Offsetting of deficiencies and overassessments.

I will take up these topics in the order named.

Administrative Practice with Respect to Depreciation

In the determination of net income, as you well know, one of the vital factors to be considered by many taxpayers is depreciation, for, excepting the cost of labor and materials, it is often the largest item of annual expense. Moreover since the amount is not susceptible of precise determination it has provided over the years a fertile field for controversy which has not been entirely confined to Federal income tax administration.

In that connection I would like to quote a statement appearing in the Public Utilities Fortnightly of October 26, 1944. Mr. Will A. Clader, certified public accountant, in an article titled "The Accounting Emphasis in Public Utility Control," says:

> "There must be realism in accounting for utility depreciation. By realism I mean depreciation seen with a remorseless scrutiny. The determination of the amount often has been the expression of a whim rather than the exercise of judgment; often by caprice rather than discretion."

It is comforting to learn that the Bureau is not alone in the difficulties encountered by public agencies,

and even certified public accountants, in this matter.

The provisions of the Internal Revenue Code respecting the depreciation allowance, that is, Sec. 23(1), have remained unchanged since the Revenue Act of 1918.

Administration of the Revenue Acts applicable to years prior to 1917 presented little or no difficulty because of the low rates of income tax and the liberal exemptions then applicable. Knowledge of the importance of the effects of depreciation was limited and little effort was made to arrive at even an approximation of the annual loss occasioned.

With the entry of the United States in the First World War and the greatly increased tax rates which followed, the importance of the depreciation allowance became apparent to all concerned. Taxpayers as well as the Bureau were handicapped in the effort to determine reasonable depreciation allowances by incomplete plant records, the lack of reliable statistical data with respect to the estimated useful lives of plant facilities and a general lack of knowledge of correct accounting principles involved in depreciation determinations. As a consequence depreciation deductions were based on estimates of useful life that were little more than guess work. Depreciation rates claimed were generally high and in the light of the subsequent history of the property accounts the amounts allowed by the Bureau were likewise excessive in many instances. During the period 1922 to 1930, income tax rates were comparatively low and the trend downward. Depreciation rates determined in connection with income tax returns filed for prior years were generally applied in those years, the Bureau relying to a large extent on the elimination from the plant account of assets theoretically exhausted, though still in service, to offset in part the effects of the application of high depreciation rates.

The impact of the depression years which followed, however, resulted in a reversal of that trend as the need for additional revenue became a matter of real concern. The fact that many taxpayers had been allowed depreciation deductions in prior years in excess of reasonable amounts was generally recognized. It was under such circumstances that the Treasury Department in 1934 issued Treasury Decision 4422 which required the submission of substantial data relating to depreciable property accounts of a large number of taxpayers. The background of events leading to the issuance of that Treasury Decision and its administration by the Bureau in connection with depreciation allowances is sufficiently well known, I am sure, to need no further elaboration. I might add, however, that in spite of the substantial reductions made in depreciation claims, this was accomplished with practically no litigation in connection with the question of estimated useful lives and depreciation rates.

Since the useful life of depreciable property cannot be fixed with certainty in advance, precise determination of depreciation is rarely, if ever, possible. Only the passing of time will reveal the accuracy or inaccuracy of life estimates made at any particular period in the life history of depreciable property. It is almost inevitable, therefore, that periodic adjustment of depreciation schedules is required if the cost of depreciable property is to be spread in some equitable manner over the period the property continues to render service. In the absence of unusual circumstances, when depreciation rates have been once adjusted by agreement with a taxpayer for a given year it is the policy of the Bureau to make no further change until sufficient time has

elapsed, ordinarily at least five years to demonstrate the accuracy of the depreciation rates applied during the intervening period. For a complete statement of Bureau policy in this, I refer you to I.T. 3639, Internal Revenue Bulletin #3, February 11, 1944.

Bureau policy as it relates to the question of depreciation generally is set forth at length in Bulletin F, and I do not believe it necesary, for that reason, to take more of your time in that connection. I have been asked, however, on several occasions whether or not a change in the method of determining depreciation allowances constitutes a change in the method of accounting such as to require prior approval of the Commissioner. That question is answered on page 14 of Bulletin F, which says "While no specific method is prescribed, whatever plan or method of apportionment is adopted must be reasonable and cannot be changed in a later year without the consent of the Commissioner."

This requirement has been supported by the Tax Court of the United States. In a memorandum opinion in the case of Edward H. Ellis, Inc., Petitioner, v. Commissioner of Internal Revenue, Respondent, Docket No. 111814, the Court said, "Since petitioner regularly employed and made its return on the straight-line method of depreciation and neither asked nor obtained prior approval by the Commissioner to change its method for 1936 or the two preceding years, we cannot approve petitioner's computation of depreciation on the hours in use basis."

Bureau Policy in Connection with Salary Deductions

One of the by-products of the current high level of war-time earnings is the problem of enforcing the statute which permits deductions for salaries only when reasonable. Here, even more so than in the instance of depreciation, the determination involves the exercise of judgment as well as the application of known facts. I needn't tell you how widely men may differ on matters of judgment.

But I should call your attention to the fact that the law specifies "reasonableness" as a criterion for the judgment of salaries and I want to assure you that we follow that guide. Sometimes in the heat of war and political disputes, you are apt to hear some pretty tall tales on this subject. With all sincerity, I prescribe a grain of salt with each such story.

There is, for instance, a widely-circulated allegation that a representative of the Bureau once advised a business executive that no person who worked with his hands could be paid as much as five thousand dollars.

So that you will get the facts officially, I quote from a public statement issued on October 6 by the Honorable Joseph D. Nunan, Jr., Commissioner of Internal Revenue. After citing the allegation, Mr. Nunan pointed out that Bureau representatives in question had denied making the statement and then added:

> "The Treasury Department has never had any such rule. In fact, in this case the government's final notice to the taxpayer permitted deductions for payments in excess of $5,000 each to 129 factory workers and 41 foremen who worked with their hands. Every dollar of wages actually paid to employees by this company was allowed as a legitimate operating expense."

I want to assure you that the Bureau has no arbitrary theories or formulas to impose upon business in this connection. The Bureau recognizes that in determining whether a salary or compensation payment is reasonable, no single factor is de-

cisive and that each case depends upon the facts and circumstances presented in that particular case. One of the tests constantly applied in determining whether payments are reasonable compensation is comparison with prevailing salaries paid to employees performing similar services in a comparable business, under like circumstances. Factors which are considered in determining reasonableness of compensation include the duties performed by the recipients, the character and amount of responsibility, the time required and the qualifications of the particular employee.

The result is that when an adjustment of salaries is proposed by the Bureau, it is usually in the case of a corporation whose stock is wholly owned by one or more officer-stockholders or by an officer and his family. Obviously, there is an important difference between corporations whose stock is widely distributed and whose salaries are fixed by arm's length bargaining, and, on the other hand, corporations dominated by officer-stockholders who may set the compensation of themselves and of their relatives to suit their fancy. Often in the latter cases the compensation follows a pattern similar to the income pattern of the corporation so that salaries are low in years of low income and high in years of high income. Where excessive compensation bears a close relationship to the stock holdings of the recipients, it is the policy of the Bureau to disallow the deduction to the extent that the salary payments are found to represent distributions of earnings upon stock.

Another factor which must be considered in relation to the reasonableness of compensation is the wartime stabilization laws relating to salaries. Where salaries are paid in contravention of the wage and salary stabilization laws and regulations, of course, the compensation must be disallowed, whether paid to employee-shareholders or to employees who are not shareholders.

Problems Relating to Applications for Changes in Taxable Years

The Bureau looks with disfavor on changes in taxable years which are requested merely for the purpose of a tax saving or a tax deferment. However, it desires to cooperate with taxpayers who wish to establish a natural taxable year or who for other sound business reasons desire to change their taxable years.

In general, Section 29.41-4 of Regulations 111 provides that the return of a taxpayer is to be made and his income computed for his taxable year, which in general means his fiscal year, or the calendar year if he has not established a fiscal year. Except in the case of a taxpayer making his first return, the regulations require that he shall make his return upon the same basis used in making his return for the preceding taxable year, unless of course, the taxpayer has received approval from the Commissioner to change.

Applications for a change in taxable years must be made on Form 1128 at least 60 days prior to the close of the fractional part of the year for which a return would be required to effect the change. As stated a moment ago, applications for such changes must be examined with a view to determining whether or not the change would result in establishing a natural taxable year. For this reason, it is to the mutual advantage of both taxpayers and the Bureau that all questions asked on Form 1128 be answered completely. This will enable prompt and intelligent action upon such applications.

In deciding what is a natural year for any taxpayer, consideration should be given to the nature of the business and the flow of its income. In a business where income is more or less uniform every month, as is usu-

ally the case in the rental of apartments in an apartment building, the year could readily close at the end of any month.

In the case of seasonal businesses in which income may be high at certain times of the year and low at other times of the year, the Bureau holds that the natural year should end with a month which is near the close of the peak period or the end of the season's operations, as the case may be.

Under this principle a department store, which normally has a peak period ending on or about December 31st, should use a year ending on either December 31 or January 31, while a construction company which is idle during the winter months should use a year ending soon after the completion of the construction season.

When a natural year is used it will result in the inventory being taken after the rush period when the stock of goods on hand is at or near the minimum and the work of closing the books and preparing reports and returns can be done during the slack period when adequate time is available for that purpose. If the accounting period were to end at the close of the slack period this work would have to be done during the rush period when less time is available for such purposes. You will observe that the above idea of a natural year corresponds very closely with the recommendations of the Natural Business Year Council which was formed to distribute information about the natural business year and to promote its adoption. Experience has shown that a large majority of the taxpayers already use accounting periods which correspond to the above principle and others are requesting changes to a natural year when they understand the advantages of such an accounting period.

Policy in Applying Pension Trust Rulings Retroactively

No discussion of the problems of administering the income tax law would be complete without a reference to the peculiar difficulties of breaking new ground. Nor could I find a better example than the task we have faced in the last two years in ruling upon pension trust and profit-sharing plans which have been submitted for qualification under the 1942 amendments to Sections 23(p) and 165(a) of the Internal Revenue Code.

The difficulty in this kind of job arises from the human impossibility of foreseeing instantaneously all of the policies and techniques which experience eventually dictates. In plain words, it means that it is inevitable that in the early stages of such a new program we will make some rulings which, however sound they appear at the time, must be revised later. In all justice and common sense, we try to avoid making these later rulings retroactive.

This is particularly true of our pension trust rulings. More than 5,400 pension trust and profit-sharing plans have been filed with the Bureau and we have been under the greatest pressure to act speedily upon all of them. More than 4,000 have been ruled upon already, with the result that in some cases rulings were issued before certain policy details had completely crystalized.

Consequently, we were faced with the decision as to whether or not to apply the subsequent policy rulings to the plans which had previously been approved. Our decision, published November 16 as No. 35 (revised) in our Pension Trust Information Service gives this answer:

"Rulings promulgated subsequent to the issuance of approval letters are not applied retroactively in cases in which there have been no material misstatements of fact. Such rul-

ings are not intended to nullify approvals which had previously been made. In certain situations, however, various rulings are applicable prospectively."

This policy statement went on to give examples of the types of cases in which the rulings would require modification for future years of plans approved prior to the issuance of the rulings. This statement also explains the time that is allowed for amending plans when necessary to comply with later rulings. Again I quote, "A ruling in effect at the beginning of a taxable year may be complied with at any time during the year provided the amendment is made effective for all purposes as of the first day of that year. Thus, in each case, there would be a minimum of 365 days and there may be as much as 729 (or 730 in leap year), depending on the date when the plan was approved, in which to make the conforming amendments."

However, there will be a problem with respect to plans adopted and submitted toward the end of the year, and this may be a continuing problem with respect to plans adopted in the future. That is, there is no provision now in the statute for retroactive qualification of plans which will be made to qualify after the end of this year. Accordingly, it might be found desirable to have a provision in the statute that newly adopted plans would qualify for tax benefits retroactive to the date of establishment of the plan, if any necessary amendments are made within a reasonably short period after adoption of the plan and submission to the Bureau for ruling. Some problem such as this might merit the consideration of Congress, and I believe the Treasury Department would be inclined to recommend its adoption if taxpayers feel the need for it.

Bureau Attitude Toward Family Partnerships

You have suggested that I discuss with you the Bureau's attitude toward family partnerships. I presume that you are principally interested in that type of family partnership which purports to be operating a business and distributing its profits on the basis of an oral or written partnership agreement. I do not believe that you are particularly interested in the other type of partnership which consists of syndicates, pools, groups, joint ventures, etc., that are classed as partnerships for income tax purposes.

I doubt that there is anyone among us who is not familiar with more than one case in which the so-called partnership has been made the device for an attempted tax avoidance. For instance, you may know of the son who paid his mother half the proceeds of his enterprises and claimed her as his partner although the mother contributed nothing in the way of property or services.(*) Or, it might be the case of the husband and wife who executed a written instrument purporting to form a partnership for the conduct of the husband's profession but failed to get by the Board of Tax Appeals because the wife contributed no capital, rendered no services, and received no accounting for any distributive share of the net earnings.[1] In this type of case, the Bureau's attitude is, as it always has been, to ignore the partnership arrangement and assess the tax against the one who in fact earned the income or who was the owner of the property producing the income. In every such case where the facts bring it within the principle laid down by the Supreme Court in the case of Lucas v. Earl, 281 U. S. 111, the Bureau has the support of the courts. The Tax Court also holds, in effect,

* George M. Cohan, 11 B.T.A. 743

[1] Thomas M. McIntyre, 37 B.T.A. 812

that one who contributes capital to an enterprise is entitled to the profits of the enterprise attributable to such capital, even in the absence of a formal partnership agreement, and that such profits may not be taxed to another.[2]

The gist of these legal principles is that the earnings of personal services and the profits produced by property belong to the person who renders the personal services and the person who owns or contributed the property, and that any arrangement by way of partnership agreement, assignment, or otherwise, which legally transfers such earnings or profits to another is in fact a gift or assignment of future earnings or profits which does not relieve the original owner of such earnings or profits from the tax. On the basis of such definite legal principles, it would seem to be a comparatively simple matter to separate the flagrant tax avoidance cases from the legitimate partnership arrangements which treat the adverse interests of the various members of the same family in exactly the same manner as such interests would be treated in a partnership arrangement between strangers dealing at arm's-length. This is true to a limited extent since, if the income of the partnership is attributable either entirely to personal services or entirely to invested capital, there is no particular difficulty involved in a comparison of the distributive interests provided by the partnership agreement with the relative value of the services rendered or capital contributed. The real difficulty or problem arises in a case where the partnership income is attributable to both personal services rendered and capital contributed.

Consider the typical case of the individual who owns and operates an individual business the income of which is attributable both to his personal services and the capital or property he has contributed and left in the business. He makes a bona fide gift to his wife of one-half of the business property or capital and then enters into a partnership agreement with her under which they are to share equally in the profits of the business. In a proper case of this kind, the Bureau does not question the bona fides of the gift nor the validity of the partnership agreement as between the parties themselves. It takes the position, however, that, for income tax purposes, the partnership agreement as to the distribution of profits is effective only with respect to the profits attributable to the capital and that insofar as such agreement provides for the distribution to the wife of one-half of the profits attributable to the personal services rendered by the husband it is an assignment of future earnings which will not relieve the husband from the tax on such profits. The situation here is somewhat analogous to that found in the case of a corporation which pays excessive salaries to its officer-stockholders. In such a case, the Bureau does not hold that the organization of the corporation is invalid nor that its dealings with its stockholders are invalid, but it does refuse to permit the corporation for income tax purposes to deduct, as an expense of doing business, amounts paid to its officers as salaries which, in fact, represent distributions of profits.

It is the policy of the Bureau to recognize the validity of family partnerships which are not clearly mere tax avoidance devices and then, wherever necessary, make such a reallocation of the partnership profits as will effect an equitable apportionment among the partners by segregating such profits as between income attributable to capital and income attributable to personal serv-

[2] Claude Nolan, 16 B.T.A. 1233

ices. For instance, such an apportionment will recognize a fair rate of return on the invested capital of each partner and the allocation of the remainder of the profits to the partner, or among the partners, to whose personal services or activities the earnings are in fact attributable.

Speeding up of Refund Procedure in Carry-back Cases

At the present time a number of carry-back claims are in the hands of the revenue agents based on returns filed for the income years 1942 and 1943. With the filing next March of returns for the year 1944 no doubt many additional claims will be filed. These claims must undergo the usual administrative procedure necessary to determine the amounts of the overpayment before the taxpayers can realize any benefit from the money owed to them by the Treasury.

The Bureau is without authority to take any short-cut to these refunds other than through efficient and expeditious examination of such claims. Recognizing this, the Treasury has under consideration certain proposals for making the carry-back benefits more currently effective. These proposals, as tentatively worked out, are as follows:

1. "If, for any taxable year beginning prior to the expiration of some reasonable post-war period, a corporate taxpayer anticipates the realization of a net operating loss or the existence of an unused excess-profits credit which could ultimately be used as a carry-back against the taxable income of the 2 prior years, it may apply for complete or partial deferment of the quarterly tax payments due in that year with respect to the preceding year's taxable income and also of any payments of deficiencies in tax which are due.

2. "The extent of the postponement of these payments would be limited to the amount of the refunds of taxes that would result from the anticipated carry-backs.

3. "A statement of the estimated amount of these losses or unused credits and of the resulting refunds would be required to be filed with the Collector of Internal Revenue, together with supporting data sufficient to satisfy him of the reasonableness of the taxpayer's claim. Generally speaking, such data would include a statement of profit and loss for at least the preceding quarter and the business circumstances tending to support a projection of the loss results, or of earnings below the credit level, for all or the remainder of the taxable year. The latter information would be of particular importance in instances where the estimated loss or credit claimed is greater than a proportionate projection of the quarterly results would indicate. Evidence of falling earnings or of anticipated reconversion costs, inventory losses, dismissal wage payments, contract terminations, and similar items would be pertinent in this connection.

4. "Partial protection should be given to the revenue by permitting acceleration of the collection of deferred payments, or other protective measures, where subsequent circumstances indicate the ultimate collection of tax to be in jeopardy.

5. "When the taxable year from which a carry-back is anticipated is completed, the usual return will be filed and a precise computation of the refunds to be claimed can then be made. The amount of the deferred payments would first be offset against the claimed amount of refunds. Any excess of deferred payments would be collected with interest. On the other hand, it is proposed that payment of any balance of refunds due would be accelerated.

"The procedure for acceleration would, it is believed, involve the

making by the Commissioner of a tentative determination of the amount due. This would be credited or refunded within the shortest possible time, probably in from 60 to 90 days. Thereafter, the final determination of claims for refund would proceed in ordinary course; on ultimate readjustment the taxpayer would repay any erroneous refunds or the Government would pay any balance of refunds remaining unpaid."[3]

Offsetting of Deficiencies and Overassessments

It is the Bureau procedure to avoid demand for deficiency taxes which can be satisfied by the offset of an overpayment. It is true that occasionally, particularly when the amount of an overpayment is in excess of $20,000, the schedule of overassessments containing the item will not be released to Collectors until a date later than that upon which the deficiency was assessed. It is our practice to make an appropriate notation on the assessment list directing the Collector to withhold notice and demand for that part of the deficiency amount which can be satisfied by crediting against it the overpayment amount.

It will be true, no doubt, that occasionally demand will be made for payment of deficiencies which should be satisfied by application of an overassessment amount, and the taxpayer or his representative in such case should call the attention of the Collector to the fact that an overassessment is involved. At the same time an appropriate communication should be addressed to the Commissioner for the attention of the Income Tax Unit and we in Washington will take the matter up immediately with the Collector to the result that the taxpayer will not be required to pay in cash an amount of deficiency which can be satisfied by crediting against it an amount of overpayment.

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Introductory Remarks on Section 722

I am sure you are expecting me to say something about section 722. This section, revised in the Revenue Act of 1942, has been widely publicized. Writers on taxation have been carried to extremes by its unique character. "Glamorous" some have called it; to others it has become "notorious." This section has been compared on the one hand to the bounty of Santa Claus and on the other to that close-fitting slipper of Cinderella which only downtrodden virtue may wear. To me it is none of these things; to me it is just one more tough assignment in tax administration such as the Bureau has handled before. I am confident that the Bureau can deal with it in a manner to accomplish the results intended by Congress, but I realize fully the size of the job.

So far, the number of applications submitted under section 722 is approximately 34,500. The amount of relief from excess profits tax requested in these applications is about 3¼ billion dollars. Before this excess profits tax period is over, it is certain that the sums involved in the administration of this section will amount to a huge total.

Types of Cases

Before discussing certain administrative problems connected with this assignment, it may be worth while to review with you briefly the types of cases that come under section 722. In every case it is

[3] Quotations from testimony by Mr. Randolph Paul, then General Counsel of the Treasury Department, in connection with his testimony on contract termination before a sub-committee of the Senate Committee on Military Affairs under date of October 27, 1943.

necessary to establish "the fair and just amount representing normal earnings," but first it must be shown that the case falls within one of the categories that qualify for relief under these provisions.

The common denominator of all section 722 cases is inadequacy of the excess profits credit (otherwise calculated) as a standard for determining excess profits. As you know, there are provisions in the Code outside of section 722 which offer relief from certain types of abnormalities, and which in many cases make the credit an adequate standard. For example, a widely used provision of this kind is the so-called deficit rule or 75 percent rule of section 713(e). Where adequate relief is obtainable through application of these special relief provisions, there is no occasion for the taxpayer to apply for relief under section 722.

Section 722 was drafted in order to provide for a wide range of abnormalities which are not adequately relieved by other provisions. It provides that in each of these situations a constructive base period net income may be used in computing the excess profits credit. To qualify for such a construction of base period earnings, however, it is not enough to show that the excess profits credit otherwise determined is an inadequate standard by some general test of reason or equity not specified in the statute. The taxpayer must show that the inadequacy was caused by one or more of the events or conditions specified in the statute.

The taxpayer which has an inadequate standard because its base period income was affected by an interruption or diminution of normal production may qualify under section 722(b)(1). If the inadequacy resulted from temporary economic depression during the base period, section 722(b)(2) may apply. In either of these closely related types, the unusual and temporary character of the depressing factor and the connection between that factor and the inadequacy of base period net income must be shown.

In another type of case, section 722(b)(3) may apply if the taxpayer's income during the base period was depressed by reason of an industry situation, either because of a variant profits cycle or because the industry characteristically has a sporadic profits pattern with good years inadequately represented in the base period. To qualify, it must be shown that the taxpayer's actual base period income was inadequate in relation to its own normal experience and resulted from one of these two unusual kinds of profits experience to which it was subjected by prevailing industry conditions.

Still another type of case is that in which the business was commenced or changed in character with the result that its actual income during the base period does not reflect the normal operation for the entire base period of the kind of business it had become by the end of the base period. I haven't time to describe the various changes in character in detail, but they must all show that the actual base period income was an inadequate standard because of factors specified in section 722(b)(4).

Section 722(b)(5) provides for any other factor causing inadequacy in base period income consistent with the principles underlying those already specified. Obviously this consistency provision is negative to the idea that any limitation under section 722(b)(1), (2), (3) or (4) may be avoided under section 722-(b)(5). So far, it has been difficult to formulate examples to illustrate a valid case under this section. Perhaps you can help us in finding cases that qualify here. Our failure to find examples is not surprising, how-

ever, since this provision was written to take care of cases that no one at that time could foresee in definite terms.

Section 722(c) applies to taxpayers not entitled to use the income method because they came into existence during the excess profits tax period. Three qualifying factors are specified in this section. In each case it must be shown that the excess profits credit based on invested capital is an inadequate standard for determining excess profits for one or more of the three reasons given in the statute.

Common Deficiencies in Relief Applications

Our experience with relief applications has revealed a number of common defects in their preparation. I appreciate, however, that many imperfections were to be expected under existing conditions in view of the novelty of the provisions, the difficulty of assembling supporting data, and the work involved in preparing a complete application.

Many applications are somewhat vague and indefinite in stating the facts upon which the taxpayer relies to qualify for relief. I do not mean merely that many checked the wrong box on Form 991, and that others attempted to "play safe" by checking all of the boxes. That matters little, provided the facts and conditions upon which the application rests are fully and definitely set forth. We can put such a claim in the right box. But failure to set down a clear basis for relief along some one of the lines specified in the statute makes it difficult to deal intelligently with the claim, however meritorious the real situation may be.

Another common fault is to rely upon generalities rather than upon specific facts and figures. The application may say that it is generally recognized that a certain industry was depressed during the base period, but what the Bureau needs to justify a refund of taxes is a definite showing that such a depression actually occurred and that its causes came within the factors specified in the statute as bases for relief. Similarly, examples embodied in reports of the Committees of Congress that were prepared when this legislation was under consideration, or in the Regulations explaining this section, have in some instances been misunderstood. The purpose of these examples was merely to illustrate various points in the law. Unless the underlying facts and conditions in an actual case are identical with those illustrated, the result may be quite different.

In making reconstructions of base period net income in order to establish normal earnings, a frequent defect is to ignore the clear prohibition in the statute against using post-1939 experience. Thus, profits earned in 1940 or 1941 are sometimes ascribed to 1939 as a starting point for the reconstruction, or certain relationships established by experience subsequent to 1939 are taken as valid for the base period. I appreciate that this prohibition increases in some cases the difficulty of finding a constructive net income. It was nevertheless included in the statute for good reasons, and the Bureau would be derelict if it accepted reconstructions based on the prohibited information.

Administrative Measures for Dealing with Section 722

It is not surprising, however, that there has been misunderstanding of some features of section 722 among taxpayers and tax practitioners; we have encountered some difficulty in getting many of the same things straightened out in the minds of our own staff. You may be interested in some of the steps taken to inform

our field men with a view to promoting consistent and equitable administration.

One of the most effective measures taken has been to call to Washington for conference key men among the revenue agents who have been assigned to work on section 722 problems. A large group representing all of the field divisions was assembled last January for a week's conference. Since that time smaller groups have been detailed to Washington for longer periods. The January conference confirmed the need for a much more detailed guidebook to section 722 than the Regulations afford. Accordingly it was followed by preparation of a bulletin, the first draft of which was sent to the field for a try-out. It has recently been rewritten to take advantage of criticism from the field and of further experience and study.

Review procedures applicable to section 722 cases in the Washington office have also received serious consideration. It is not contemplated that there will be any radical departure from the usual path that all refund cases take. It may be necessary, however, to reopen upon review a higher proportion than usual of the early cases which were closed in the field without benefit of the bulletin and other aids that are now available to the revenue agents.

The B. and I. Research Division

It is evident from the thumbnail sketch of section 722 which opened my discussion of this subject that economic considerations play a large part in the settlement of these cases. Although many of our revenue agents have acquired some working knowledge of economics as a byproduct of experience, observation, and reading, in general these economic issues go beyond their field of training and experience. Many of these problems require investigations that only trained economists can make. After thorough consideration of the subject it was decided that the best way to take care of this situation was to set up in Washington an economics research staff to assist and advise the revenue agents and other officials of the Bureau in dealing with these economic problems and issues.

Accordingly, in August 1943 the Business and Industrial Research Division was established in the Income Tax Unit of the Bureau to act in an advisory capacity on economic issues involved in the administration of section 722. The recruitment of suitable men under existing conditions and their orientation to the work of the Bureau and to these highly specialized problems has required some time, but we now have in this new division a "going concern" which has some of the most troublesome initial problems behind it, although the major part of the job still remains to be done.

The functions of this research division, as I have indicated, are advisory in character. It makes recommendations with respect to all types of economic problems in regard to which the agent or other officer dealing with a section 722 claim needs advice. Its investigations have included general matters, such as the influence of drought on business profits; specific industry studies with analyses of profit factors and measures of profits experience; and investigations of specific economic issues relating to particular cases. This division is giving special attention to the status of industrial groups and industries with respect to the variant cycle provisions. It is also compiling and analyzing statistics from all available sources, including income tax returns, in order to meet requests from the field or to supply statistical data for its own studies.

Problems come to the B. I. Division both by reference from the field and as part of the program which it has developed to anticipate questions and to deal systematically with issues which in the nature of the case require economic investigations. Its statistical compilations include some measures of the general business profits cycle based on our *Statistics of Income* series which the Bureau expects to release shortly for the information of the interested public, with appropriate explanation of the significance of these measures.

Need for a Cooperative Approach Section 722

In view of the difficulties involved in applying the new and unusual provisions of section 722, a heavy task confronts both taxpayers and the Bureau. This task calls for effective cooperation on the part of all concerned. On its side the Bureau is assisting taxpayers by making public the bulletin on section 722 which it is issuing for the guidance of its own employees. As stated in the foreword, this bulletin does not have the force of a published ruling or a Treasury Decision, but it does represent the current trend of official opinion in the administration of section 722.

We realize that some of the subjects dealt with in the bulletin are highly controversial. If you think the Bureau is wrong in any of the positions taken, we want you to tell us why you think so. We want to bring differences of opinion out into the open and thresh them out in the hope of reaching satisfactory conclusions on some points, at least, without waiting for adjudication in The Tax Court. Whether or not you agree with all the positions taken, we trust that the constructive suggestions which the bulletin contains for establishing claims under the various provisions will be helpful to taxpayers and tax practitioners in making and perfecting relief applications.

In closing this part of my discussion, it may be well to point out that the provisions of section 722 may be a test not only of the Bureau but of the taxpaying public as well. It is clear that there will be sincere differences of opinion and that some problems will arise which will have to be clarified by decisions of The Tax Court. Nevertheless, a multitude of issues in particular cases under section 722 can be settled fairly and expeditiously only if all parties concerned try to look at the problem impartially and make a real effort to find a fair standard of normal earnings in accordance with the principles set forth in the statute. Unless these questions are approached in a spirit of cooperation with a genuine desire of all concerned to find reasonable answers, relief under section 722 is likely to fail of its purpose; and that failure would prejudice all future attempts to alleviate a heavy burden of Federal taxation by introducing a certain degree of flexibility in order to prevent extreme hardship in the unusual case.

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Pension and Profit-Sharing Plans

The Revenue Act of 1942 made extensive amendments to the provisions of sections 23(p) and 165(a) of the Internal Revenue Code dealing with the income tax status of pension and profit-sharing plans. Those of you who have dealt with the subject are familiar with the principal features of this legislation. The tax benefits granted with respect to qualified plans are threefold. First, the law permits deductions, within certain liberal limits, for employer contributions made to such plans in the year the contributions are paid, although the taxpayer is funding an obligaiton which will not mature until some time in the future. Second, the employee is not

required to pay a tax on the employer contributions set aside for his benefit until he actually receives the benefits, at which time he will probably be in a much lower tax bracket because his regular salary will have ceased. In effect, the employee is receiving additional compensation without becoming subject to higher surtax rates. Third, in case of trusteed plans, the income on the trust investments is entirely exempt from Federal income tax.

In order to qualify for these tax benefits, plans must conform to certain requirements set forth in the statute. A plan set up by an employer must be for the exclusive benefit of his employees. There must be no possibility of the funds being diverted to purposes other than for the exclusive benefit of employees prior to the satisfaction of all liabilities with respect to employees and their beneficiaries. Neither the eligibility requirements, nor the contributions or benefits under the plan, may discriminate in favor of employees who are officers, shareholders, supervisors or highly compensated. The statute, as further amended by Public 201 which became law on December 17, 1943, gave taxpayers until December 31, 1944, to amend these plans to satisfy the requirements with respect to discrimination.

About the same time that the amended legislation with respect to the tax status of pension and profit-sharing plans became effective, along with greatly increased tax rates and high war profits there was a tremendous increase in the number of these plans established. It is estimated that since the entry of this country into the war, over 5,000 new pension and profit-sharing plans have come into existence. Well over 6,000 plans have been filed with the Bureau of Internal Revenue for advance ruling as to their qualification under section 165 (a). This number represents probably four times the number of plans which were in existence prior to 1942 and perhaps ten times the number of plans which were adopted prior to 1937. In addition, there are undoubtedly hundreds of plans which for one reason or another have not been filed with the Bureau for ruling. The aggregate deductions claimed with respect to contributions under all of these plans may well exceed a billion dollars a year.

Of the more than 6,000 plans which have been filed, over 5,000 have been ruled upon. Most of the remainder are in process in various stages, such as review of amendments after conference, awaiting amendments after conference, or awaiting conference with the taxpayers. There were only about 200 plans of this total on which no action has been taken or contact with the taxpayer made. Practically all of these 200, as well as a large majority of those in process, were plans which had been filed with the Bureau in the past two months.

Early this summer, when the number of plans filed with the Bureau was already in excess of 3,000, it became apparent that in order to act upon all plans by the December 31, 1944, deadline, including review of the required amendments, it would be necessary to decentralize most of the work to the field offices. Since experience had already shown that nearly all cases required amendments and a large proportion of them required conferences, it was obvious that the only way in which the work could be handled expeditiously was to decentralize it so that the conferences could be held in most instances near the taxpayer's place of business. Consequently, the responsibility for ruling on the bulk of the cases was delegated to the Internal Revenue Agents in Charge in the field. Because of the various special problems arising in most older

plans, it was decided that the cases put into effect prior to January 1, 1942, would continue to be handled in Washington.

The Internal Revenue Agents in Charge have assigned over 300 revenue agents to the work of reviewing pension and profit-sharing plans in regard to requests for advance ruling. With such a large number of different agents, most of whom had no previous training for this type of work, spread throughout 38 field offices, certain standards had to be set with respect to the major features in pension and profit-sharing plans in order to insure fair and uniform treatment in the handling of plans throughout the country. Many of you are probably familiar with the rulings which have been published with respect to the principal features of pension and profit-sharing plans, some of which I will refer to briefly.

One of the major characteristics found in about half of a large sample of plans put into effect since the beginning of 1942 is that employees who have a substantial stock interest in the corporation participate in the benefits of the plan to an important degree. These plans vary from cases in which stockholder employees participate in only a moderate share of benefits, consistent with their position as employees in the organization, to cases in which the plan was obviously designed as a device for distributing dividends to shareholders without subjecting the proftis to corporate income tax or to immediate individual income tax. It is clearly the duty of the Bureau not to allow the latter type of case, but it is often difficult to draw the line. With so many plans involved and with several hundred Revenue Agents in many different locations reviewing these plans, it was obviously desirable to set fairly definite limits for the exercise of individual judgment as to whether a plan with important shareholder participation could qualify as a non-discriminatory plan for the exclusive benefit of employees. As a consequence, the Bureau released the rule expressed in I. T. 3674 that a pension or profit-sharing plan will not generally be considered for the benefit of shareholders if the contributions which are required to provide benefits for employees, each of whom owns more than ten percent of the voting stock of the corporation, do not exceed, in the aggregate, 30 per cent of the contributions for all participants under the plan. While the facts and circumstances of particular cases vary, it can hardly be considered that, for the great majority of cases, a 30 percent figure for stockholder participation is too restrictive.

Another feature which has occasioned considerable discussion is that which has been referred to as "Integration with Social Security benefits." Many plans restrict eligibility to employees whose annual compensation is in excess of a certain figure, such as $3,000 a year, or provide a higher rate of benefits for that part of the compensation in excess of $3,000 a year than for the first $3,000 of compensation. The statute provides that, in order to qualify, a plan must not contain an eligibility classification which is discriminatory in favor of employees who are officers, shareholders, supervisors, or highly compensated, nor may the contributions or benefits under a plan discriminate in favor of such employees. However, the statute further provides that a classification shall not be considered discriminatory nor shall the contributions or benefits be considered discrimnatory *merely because* the plan excludes employees whose whole remuneration constitutes wages used as a basis for Social Security benefits or *merely because* the contributions or benefits on that part of an employee's

remuneration which constitute such wages differ from the contributions or benefits based on an employee's remuneration in excess of such wages. As stated in the Congressional Committee reports, the latter provision was inserted in order to make it possible for plans which supplement the Social Security program to qualify. Accordingly, the regulations provide that an earnings classification with respect to eligibility or with respect to contributions and benefits may be deemed discriminatory unless the proportionate differences in benefits as between employees earning in excess of such classification and those earning below that classification are approximately offset by the benefits provided by the Social Security Act. Commissioner's Mimeograph 5539 released July 8, 1943, gives specific rules carrying out this principle.

A third feature which has commanded considerable attention in connection with the question of discrimination is that although pension plans may provide for termination at will by the employer, in certain cases early termination will result in the discrimination prohibited by the statute. This may occur, for example, where certain officers or highly compensated employees are within a few years of retirement age at the inception of the plan, and the operation of the plan and its funding methods will result in funding and vesting their benefits in a short period. If the plan is terminated after their benefits are paid for and vested, and when very inconsiderable contributions have been made for other employees, extreme discrimination will very likely result in the benefits which actually become payable under the plan. Possibilities of such discrimination are especially great in plans which have been operating for only a few years. In order to limit the possible discrimination, it is required that plans established in the past few years must contain certain restrictions on the guarantee of benefits for the most highly compensated employees during the early years of operation of the plan. These restrictions have been set forth in Commissioner's Mimeograph No. 5717 issued under date of July 13, 1944.

A fourth feature whcih must be examined for qualification of plans under section 165 (a) is the factor of definiteness. The tax deductions under section 23 (p) are allowed with respect to contributions under a *plan*. The term plan implies a definite written permanent program. In a pension plan the benefits must be definitely determinable. In a profit-sharing plan there must be a definite formula for employer contributions, and the distribution of such contributions among employees must also be in accordance with a definite formula. These requirements with respect to a profit-sharing plan were published in I. T. 3661. It seems only proper that the factor of definiteness should be a minimum requirement for allowing the tax advantages granted by the statute, in order to distinguish between legitimate *plans* for the exclusive benefit of employees, and out and out devices for keeping profits out of the hands of the tax collectors.

Another important ruling, which was published as PS No. 19 in the Pension Trust Division Information Service, is that in order to qualify under section 165 (a) an employee must have the unrestricted right to name his own beneficiary under the plan. Otherwise the plan cannot be considered for the exclusive benefit of employees.

Many other features, which are less common, but in particular cases may be even more important, must be scrutinized. Many of these other provisions are such that no general rules can be laid down which would apply equitably in all cases. Such provisions must be considered in

connection with *all* the provisions and circumstances of the particular case, and the probable effects of the entire plan in operation. For example, in the case of the ordinary stabilized business, the broadest possible coverage under a plan is a desirable feature, since it tends to eliminate discrimination; on the other hand, in a temporarily inflated concern, coverage of large numbers of short-service employees may be purely a device for overfunding the costs of the plan during high tax years, so as to relieve the employer of the burden of carrying the plan for the permanent employees in later years. Thus, pretended coverage of large numbers of employees who are not likely to remain in service long enough to get any benefits under the plan may be a feature designed to benefit the employer rather than being for the exclusive benefit of employees.

It has been found that nearly all plans require some amendments to the form originally submitted, in order to qualify under section 165 (a). This fact serves to emphasize the tremendous administrative burden which has been imposed upon the Bureau and assumed by it in ruling on the vast number of plans which have been submitted. One compensating factor in most cases is the excellent cooperation and willingness of the taxpayers to make the necessary amendments.

The progress which the Bureau has made in recent months in issuing rulings gives every indication that we will complete the job by the December 31, 1944, deadline, of disposing of all plans which were filed reasonably in advance of the end of the year. I think there will be no occasion for the Treasury to seek a further general extension of time. However, there will be a problem with respect to plans adopted and submitted toward the end of the year; and this may be a continuing problem with respect to plans adopted in the future. That is, there is no provision now in the statute for retroactive qualification of plans which are made to qualify after the end of this year. Accordingly, it might be found desirable to have a provision in the statute that newly adopted plans would qualify for tax benefits retroactive to the date of establishment of the plan, if any necessary amendments are made within a reasonably short period after adoption of the plan and submission to the Bureau for ruling. Some proposal such as this might merit the consideration of Congress, and I believe the Treasury Department would be inclined to recommend its adoption if taxpayers feel a need for it.

While we have thus made encouraging progress and can forsee the successful completion of the initial huge task of ruling on the qualification of pension and profit-sharing plans under section 165 (a), many complex problems must still be solved relative to passing on deductions for contributions to such plans claimed under section 23 (p). The Bureau will have a continuing heavy burden in connection with administering this part of the Code.

Some Aspects of the New York Franchise Tax—Part I*

By Emery W. Burton

ABOUT a year ago when we of the Tax Department attended your annual meeting the revision of Article 9-A was in the so-called laboratory stage. Commissioner Browne and others had some ideas but nothing had crystalized. These ideas have now been enacted into law and constitute new Article 9-A. I don't mean that all of the bugs have been completely ironed out, but at least we do have a new law.

As most of you know, one of the principal objectives was to put the franchise tax on a current basis. In view of the fact that the tax under the old law was a future tax, it was not easy to make the changeover. However, a novel scheme was devised to do this. The period required to make this change is covered by a so-called "interim-tax". Under this scheme there will not be in any case any doubling up of tax liability. No corporation will be required to pay more than one tax measured by its income or capital of any one year. Neither will such a corporation be required to pay two taxes in any one year (except certain holding corporations). I won't attempt to cover these exceptions at this time, as they constitute only a very small group of taxpayers. Even in these cases there is no doubling up of tax liability, but only an acceleration of the filing and payment dates so as to immediately put such corporations on a current basis.

Let us take, for example, a corporation which keeps its books and files franchise tax returns on a calendar year basis ending December 31. On May 15, 1944 it filed a report based on its operations during the year ended December 31, 1943. This report, under new 9-A, covers the first part of the so-called interim tax and is for the privilege period November 1, 1944 to December 31, 1944. The report due May 15, 1945, based on operations of the year ending December 31, 1944, is also for the privilege period November 1, 1944 to December 31, 1944, and covers the second part of the so-called interim tax. With the filing of the report due May 15, 1946 the taxpayer becomes current, and the next tax is for the privilege period January 1, 1945 to December 31, 1945. From then on the taxpayer is on a current basis.

In the case of corporations keeping their books on a fiscal year basis and filing tax reports on such basis, the privilege period under the "interim tax" begins on November 1, 1944 and ends on the last day of such fiscal year ending after November 1, 1944.

For example, let us take a corporation reporting on a fiscal year ending July 31. Such a corporation filed a report on May 15, 1943 based on its operations for the fiscal year ended July 31, 1942 for the privilege period begun November 1, 1943. On May 15, 1944 it filed a report based on its operations during the fiscal year ended July 31, 1943. The

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* Presented at the December 11, 1944 meeting of the Society.

tax based on that report was for part of the "interim tax" and covered the privilege period November 1, 1944 to July 31, 1945. On May 15, 1945 a report will be filed based on operations during the fiscal year ended July 31, 1944, and will also cover the privilege period November 1, 1944 to July 31, 1945. On May 15, 1946 a report will be filed based on operations during the fiscal year ending July 31, 1945. The tax based on this report is also for the privilege period November 1, 1944 to July 31, 1945. This is the last part of the "interim tax".

On May 15, 1947 a report will be filed based on the operations during the fiscal year ending July 31, 1946. The tax on that report will be for the privilege period August 1, 1945 to July 31, 1946. This is the first permanent tax under new Article 9-A and beginning with such year the corporation is on a current basis.

You will note that it takes three base years to accomplish the transition from a past to a current basis. It likewise takes three base years to accomplish this in the case of all corporations reporting on a fiscal year ended August 31, September 30 or October 31.

Corporations having fiscal years ending on the last day of January, February, March, April, May or June only require two base years to make the change over.

I have not attempted to give an example of each fiscal year. When the regualtions are published they will include an appendix which will cover each case.

The change to a current basis as accomplished by new Article 9-A is desirable for a number of reasons. Under the old Article 9-A when the tax was imposed for a future privilege, it was possible for a corporation to do business within the state and earn large profits for a period of over a year and a half, in some cases, without ever paying any tax measured by such profit for the privilege enjoyed of doing business in New York State. Another undesirable feature of old Article 9-A was the fact that a corporation paid its tax for the privilege it enjoyed as of November 1 of each year and a corporation only had to be in existence on that day, or doing business on that day if a foreign corporation, to become liable for the same tax as a corporation which enjoyed the privilege throughout the year. These disadvantages have been eliminated under the permanent tax due under new Article 9-A which now measures the corporation's tax for the same period during which the corporation enjoyed the privilege of doing business within the state. Thus a corporation now pays in proportion to the benefit received.

Before the enactment of new Article 9-A, the New York Tax Law classified separately "holding corporations", "investment trusts" and ordinary business corporations, and subjected each class to a different kind of franchise tax. These formal distinctions are abolished by the new law. Under this law a corporation is treated as a holding corporation to the extent that it holds investments in subsidiaries, as an investment trust to the extent that it holds other securities, and as a business corporation to the extent that it is engaged in ordinary business.

Business income is allocated by a business allocation percentage.

Investment income is allocated by an investment allocation percentage.

The separation of income under new Article 9-A into different classes of income with separate treatment for each such class of income was designed to extend to business corporations any preferential treatment accorded to investment corporations where a business corporation was engaged to some degree in investment activities. The Tax Department is well aware of the fact that

an investment company will only remain in New York and transact its business here so long as the tax imposed upon it is reasonable enough to prevent such a corporation from moving outside the state to avoid New York taxes. Such preferential treatment is provided for in new Article 9-A by imposing the tax on dividends received from stocks and other securities with the exception of dividends from subsidiary securities at one-half the regular rate, and income, gains and losses from subsidiaries are eliminated completely from the computation of entire net income. To compensate for the elimination of such subsidiary income, a capital tax at a low mill rate is imposed upon the subsidiary capital held by the taxpayer. This subsidiary tax is added to the regular tax of the corporation and the two together make up the corporation's New York tax.

In computing entire net income under new Article 9-A we ordinarily start with net income reported to the Federal Government. We then add to Federal net income all interest income which was not included in computing Federal net income, such as interest on State and Municipal bonds and certain obligations of the United States and its instrumentalities.

We also add the following items which were deducted in computing Federal net income:

(1) All Federal taxes on or measured by income or profits.

(2) Net operating losses of other years.

(3) All New York franchise taxes.

(4) 90% of interest paid to stockholders or members of their immediate families owning more than 5% of the taxpayer's issued capital stock; provided, however, that the total amount of such interest to be added shall not be more than the excess over $1,000 of all such interest. No adjustment need be made for any interest paid or accrued on bonds or other evidences of indebtedness issued, with stock, pursuant to a bona fide plan of reorganization to persons who, prior to such reorganization, were bona fide creditors of the taxpayer or any predecessor corporation, but were not stockholders thereof. Also, no adjustment is required for any interest paid or accrued to stockholders of a taxpayer not taxed on the basis of a consolidated report, the investment income of which is more than 85% of its total business and investment income and which elects to allocate its entire net income by its investment allocation percentage.

(5) All losses from subsidiary capital.

(6) Any excessive profits eliminated on renegotiation of war contracts, or sub-contracts, not finally determined during the base year.

If a taxpayer was organized outside the United States we add to the entire net income reported to the Federal Government all income from sources outside the United States, less all allowable deductions attributable thereto.

We then deduct from Federal net income the following items which were included in Federal net income:

(1) All income and gains from subsidiary capital (less, in the discretion of the Tax Commission, any deductions allowed in computing Federal net income which were directly attributable, as a carrying charge or otherwise, to subsidiary capital or to income and gains therefrom). Other income from subsidiaries is not deductible. We also deduct:

(2) 50% of all dividends from corporations other than subsidiaries;

(3) All New York franchise taxes actually paid during the period covered by the report; and

(4) Any foreign income and profits taxes, any part of which was allowed as a credit against the Federal tax.

Some of you will be pleased to learn that the department has decided to make some changes in the method of taxing corporations which are permitted to file consolidated reports. Under the procedure previously in effect a one mill tax was asserted against each subsidiary included in the consolidated report which had no net income. This will no longer be done. The consolidated tax will be placed against either the parent or one of the other corporations in the consolidated group, and a minimum tax of $25.00 will be asserted against each of the other corporations.

If there is no consolidated net income, or if the tax on a consolidated one mill basis exceeds the tax measured by consolidated net income, the one mill tax will be computed on the fair market value of the consolidated assets, less consolidated current liabilities. Under the old procedure the net worth or issued capital stock (whichever was greater) of each corporation included in the consolidated report was added together and the one mill rate was applied to the total. This method produced an unfair result and we have decided to correct our procedure. These changes, I believe, are a step in the right direction and I am sure your clients will welcome them.

The consolidated provisions of the new law may make it necessary to review some of the cases in which permission was previously granted by the department for the filing of consolidated reports. If any of your clients have any problems along this line we will be pleased to confer with you or them, if possible, prior to the filing of your next report. A request for such a conference should be made in advance, as we are very busy in Albany.

I was not asked to speak about renegotiation of war contracts, but I believe some mention should be made of this subject. All that I wish to say about it is that it is a great big headache for the department. We have been unable to clear a number of these cases and we hope that you and your clients will be patient. The balance of franchise tax is due not later than January 15, 1945. If your clients have not received a tax bill, they should forward to the department, prior to such date, the balance of the tax as they have computed it, less any credit to which they believe they are entitled. This will eliminate any question of interest charges.

Some Aspects of the New York Franchise Tax—Part II*

By MORTIMER M. KASSELL

I HAVE been asked to discuss three features of the new franchise tax on business corporations imposed by Article 9-A of the Tax Law, as added by Chapter 415 of the Laws of 1944. I intend to discuss the broad features of the law and not attempt to go into refinements which, while important, would only serve to obscure the main points. Hence, I shall run the risk of sacrificing technical accuracy in favor of simplicity.

The first question is the accrual of the franchise tax for purposes of the Federal income tax and also for purposes of the franchise tax itself.

Under old Article 9-A a calendar year corporation filed a report on May fifteenth for the privilege year beginning the following November first. The tax was a future tax, being payable before the beginning of the privilege period and being measured by past earnings. Every corporation which was subject to tax on the first day of the privilege period was liable for the entire tax on that date, even though it ceased to exist soon after. Accordingly, it was clear that the entire tax accrued on November first and was deductible in computing the net income of the corporation for Federal income tax purposes in the return for the accounting year in which such November first fell. Since entire net income was presumably the same as Federal net income, the entire tax also accrued and was allowed as a deduction in computing entire net income for purposes of the franchise tax itself. For accounting purposes, since the entire tax accrued on November first, I assume it was set up as an accrual on the books of the corporation as of that date.

MORTIMER M. KASSEL, author of **Some Aspects of the New York Franchise Tax,—Part II,** is Deputy Commissioner and Counsel of the New York State Tax Commission.

It is essential to have clearly in mind the privilege period of the new permanent tax and also the privilege period of the temporary tax, which was designed to cover the transition between the old privilege year and the new privilege year.

New Article 9-A is designed to put each taxpayer on a current basis so that the privilege period and the base period will coincide.

The transition tax for the two month privilege period beginning November 1, 1944 is a future tax and accrues on November 1, 1944. Since it accrues on November 1, 1944, the entire amount of the tax which the corporation computes on the reports filed on May 15, 1944 and on May 15, 1945, may be set up as an accrual and deducted in computing Federal net income for the calendar year 1944. The Commisssioner of Internal Revenue has ruled that such deduction is proper.

The question of the accrual of the franchise tax for purposes of the franchise tax itself is a wholly different one and under the present provisions of Article 9-A a wholly different result follows. Even though both parts of the temporary tax may accrue on November 1, 1944, section

* Presented at the December 11, 1944 meeting of the Society.

208 of the Tax Law provides in subdivision 9 that a deduction for the franchise tax shall be allowed "only in computing entire net income for the year in which such tax was paid and no such tax shall be allowed as a deduction more than once." Thus a corporation cannot deduct the same amount for New York franchise taxes as it deducted on its Federal income tax return for the same year. New Article 9-A puts the corporation on a "cash" basis with respect to deductions for such franchise taxes. Accordingly, in the report filed by the corporation on May 15, 1945 based on its 1944 income it may deduct only the tax actually paid by it in 1944.

Put simply, the two taxes which accrued in 1944 are deductible under the Federal law but only the tax which is paid in 1944 is deductible under the New York law.

It is unfortunate that this difference should exist, and I personally am hopeful that it will be eliminated.

The permanent franchise tax first payable by a calendar year corporation in 1946 (based primarily on its 1945 income) accrues, according to the Commissioner of Internal Revenue on January 1, 1945. However, it may well be argued that it accrues over the course of the year 1945. In either event there is no doubt that it accrues in 1945.

Allocation

The next aspect of new Article 9-A which I have been asked to discuss is the various allocation formulae embodied in the statute.

Under old Article 9-A, only a corporation which maintained a regular place of business outside New York was entitled to any allocation. It has been frequently pointed out that the formula employed under old Article 9-A to allocate entire net income was unique. The three facors in that formula were property, accounts receivable and stock of other corporations owned by the taxpayer. The basic weakness in that allocation formula is the fact that the investment activities of a corporation, even though having no relationship, influenced an allocation of strictly business income. The result under it was a distortion of income allocable to New York, frequently with inequity either to the taxpayer or to the state.

New Article 9-A recognizing that for allocation purposes many corporations have different classes of income — generally business and investment income—provides distinct methods of allocating each class of income. This is the so-called "double allocation formula" which is applied to entire net income.

Every taxpayer is entitled to allocate its investment income even if it only does business in New York. However, only a taxpayer which maintains a regular place of business outside New York is entitled to allocate its business income.

Business income is allocated by a "business allocation percentage." The percentage is obtained by taking the three factors of tangible property, business receipts and payrolls in and out of the state.

The business allocation percentage generally speaking, contains substantially two of the three factors formerly used under Article 9-A, even though the treatment of these factors is somewhat different. The property factor—the proportion that real and tangible personal property in the state bears to all such property—is similar to that under old Article 9-A. The receipts factor takes the place of the factor of "accounts receivable" used under old Article 9-A. New York receipts include those arising (1) from sales of tangible personal property located in New York at the time of the receipt of or the appropriation to the orders, (2) from sales of such property not located at the time of the

receipt of or appropriation to the orders at any permanent or continuous place of business maintained by the taxpayer without New York, where the orders were received or accepted in New York, (3) New York services, (4) New York rentals, (5) other New York business receipts. However, in place of the so-called "stock factor" there has been substituted the payroll factor. These changes bring allocation for New York franchise tax purposes more nearly in line with that adopted in some ten or eleven states and is in accord with the recommendation of the Committee on Allocation of the National Tax Association.

Investment income is allocated by an "investment allocation percentage" based on the amount of capital employed in New York by the corporation issuing the taxpayer's investments and on the location of the municipal, state or Federal governments issuing the taxpayer's investments. This percentage is not too dissimilar from the so-called "stock factor" under the old law but is applied only to investment income.

Many corporations, however, will find it unnecessary to use both allocation percentages. A taxpayer which has only business income will allocate its entire net income by the business allocation percentage. This will cover the many corporations, such as mercantile or manufacturing corporations, which have no subsidiaries and have no investments in stocks, bonds or other securities. In addition, many other corporations need only compute a business allocation percentage because the statute gives the taxpayer an election so that if its business income is 75% or more of its total business and investment income, it may elect to allocate its entire net income by the business allocation percentage. Finally, a taxpayer which has business income and an investment loss uses only the business allocation percentage.

It should be emphasized that a taxpayer which does not maintain a regular place of business outside New York may not allocate any part of its business income. Its business allocation percentage is accordingly 100%.

Just as many taxpayers need only be concerned with a business allocation percentage there are others which need only be concerned with an investment allocation percentage. Thus, a taxpayer which has only investment income, *e.g.,* an investment trust having no business income and no subsidiaries, will allocate its entire net income by the investment allocation percentage. A similar election to that mentioned above is provided so that if a taxpayer's investment income is more than 85% of its total business and investment income, it may elect to allocate its entire net income by its investment allocation percentage. Finally, a taxpayer which has investment income and a business loss uses only an investment allocation percentage.

Thus far, we have dealt with two large classes of corporations—those which need only be concerned with either the business allocation percentage or the investment allocation percentage. However, there are many corporations which have both business income and investment income and which are not entitled to an election. These taxpayers are required to allocate their entire net income by the "combined allocation percentage." The combined allocation percentage as its name indicates, is a composite. It is obtained (1) by applying the business allocation percentage to its business income, (2) the investment allocation percentage to investment income, (3) adding the products, and (4) dividing the total by the sum of the taxpayer's business income and investment income. In other words,

separate and distinct consideration is given to the amount of business income and its allocation and its investment income and its allocation.

Thus far mention has only been made of the allocation of income. As in the case of allocation of income, a taxpayer may allocate its investment capital, regardless of whether it is doing business only in New York, but a taxpayer may allocate its business capital only if it maintains a regular place of business outside New York. The amount of business capital allocated to New York is obtained by multiplying business capital (as defined) by the business allocation percentage and investment capital allocated to New York is obtained by multiplying investment capital (as defined) by the investment allocation percentage. Adding the two together gives the amount of business capital and investment capital allocable to New York. There is a 15% floor, however, on the amount of investment capital allocable to New York. Similar elections with respect to capital are allowed to taxpayers having the required percentage on business or investment income. However, as noted above, many taxpayers will only need to be concerned with one or the other allocation percentage.

Tax on Corporations Ceasing to Exercise Franchises or Do Business in New York

Subdivision 3 of section 209 imposes a tax on every taxpayer which ceases to exercise its franchise or do business in New York on or after March 31, 1944.

The tax is measured by the entire net income of the taxpayer

(a) for every year or part thereof during which it was exercising its franchise or doing business in New York,

(b) which has theretofore not been used in the computation of the franchise tax, and

(c) which would have been used in the computation of such franchise tax if the taxpayer had not ceased to exercise its franchise or do business in New York.

The tax is computed in the same manner and at the same rates as though there had been no cessation of business. It should be noted that the tax is measured only by entire net income and not by any of the so-called alternative methods.

A domestic corporation becomes liable to tax under this section when it ceases to exercise its franchise, for example, when it dissolves, when it merges or consolidates into another corporation, or when it ceases in any other way actualy to exercise its franchise. As distinguished from the franchise tax which is imposed on domestic corporations for the *possession* of the franchise, the tax here under consideration is imposed on domestic corporations which actualy cease to exercise their franchise, and accordingly, I have ruled that a domestic corporation which ceased to exercise its franchise on or before the effective date of Chapter 415 of the Laws of 1944 (March 31, 1944) was not liable to tax under this section, even though it actually filed a certificate of dissolution after that date. Once a corporation is on the so-called "permanent" basis, it is contemplated that the tax imposed by subdivision 3 of section 209 of the Tax Law will not come into play because if, for example, a calendar year corporation ceases to do business on July 1, 1945, it will be subject to the permanent tax for the privilege of doing business from January 1, 1945 to July 1, 1945 and will pay a tax measured by its entire net income or other applicable basis for that six months period.

A taxpayer subject to the tax under consideration is required to file a separate report showing its entire net income for each year or

any part thereof up to the date it ceases to exercise its franchise or do business to the extent that such net income has not previously been used in computing the franchise tax.

Reports are required to be filed on the date of cessation of business, unless an extension of time is granted by the State Tax Commission. An application for such extension should be made prior to the date of cessation. This tax is payable with the filing of the report.

I know that there are many provisions in the statute which may sound technical, and if I have clarified them in some small way, you may find your examination of the tentative regulations and the tax form prepared by the State Tax Commission less difficult.

Naturally, with a new law many difficult questions arise. With the help and cooperation of your Society and others with a similar public interest, we hope to be able to provide an administration of the franchise tax that will minimize the burden of tax compliance on taxpayers and their legal or accounting representatives.

Preparing a New York Franchise Tax Return in 1945

By Benjamin Harrow, C.P.A.

THE new tax law introduces a number of novel concepts. It is full of such things as subsidiary income and capital, investment income and capital, combined allocation percentage, etc.

Now it was thought advisable, in order to clarify some of these things, to submit to you certain schedules. They are not exactly in the form in which they will ultimately appear on the tax return, but they will give you an opportunity to visualize the sort of thing you are going to be up against, particularly the innumerable computations that you will have to go through.

Now I am going to emphasize (and try not to repeat) some of the things that have been said here this evening; I am going to emphasize some of the things you will actually have to bear in mind when you sit down to prepare the new franchise tax return in accordance with the new law.

The return will require an analysis of income in order to compute total investment income and total business income. All items of income will of course be listed and classified. Dividends received from subsidiary stocks wil be excluded in full and only 50% of dividends from investment stocks will be included as investment income.

Interest will be classified into about five categories. Interest from subsidiaries will be excluded in full provided such interest is not claimed by the subsidiary companies as a New York franchise tax deduction. If it is so claimed as a deduction, the interest will be listed as investment income. Interest from investment securities will be included separately as investment income. A corporation may be in receipt of interest on items other than securities, accounts receivable for example. If such interest is claimed as a deduction by the subsidiaries on their New York franchise tax returns, such interest will be listed as business income. Interest on bank accounts will be classified either as investment income or business income at the election of the taxpayer. It is of course not necessary to be reminded that interest on State bonds and certain United States Government bonds not subject to Federal income tax are taxable under our so-called "franchise tax" and will of course be included as investment income.

The computation of capital gains and losses may also involve a number of calculations. Net capital gains from sales and exchanges of subsidiary stocks and securities will be excluded entirely. Net capital gains from sales and exchanges of investment stocks and securities will be listed as investment income. Net gains from sales and exchanges of other capital assets will be listed as business income. Net capital losses from sales and exchanges of investment stocks and securities and

Benjamin Harrow, C.P.A., author of **Preparing a New York Franchise Tax Return in 1945,** is chairman of the Committee on State Taxation. He has been a member of the Society since 1928 and is presently serving as a director. He is co-author, with Mr. Isidore Sack, of New York State Income and Franchise Taxes.

net capital losses from sales and exchanges of other capital assets will be listed separately. A deduction will be allowed for a net loss on stocks and securities, but not in excess of any net capital gain or capital assets other than stocks and securities, and a deduction will be allowed for a net loss on capital assets other than stocks and securities but not in excess of any net capital gain on investment stocks and securities. These computations are necessary because the Federal law does not allow a deduction for net capital losses, and entire net income under the State franchise tax law is presumably the same as net income under the Federal law.

Deductions follow generally the items appearing on a Federal income tax return with the following exceptions: Bad debts must not include debts from subsidiaries on which interest is not claimed by the subsidiaries as New York franchise tax deductions. Interest on indebtedness to stockholders or members of their immediate families owning in the aggregate in excess of 5% of the capital stock of the corporation is deductible only to the extent of 10% of such interest, or $1,000, whichever is larger. Interest incurred to carry subsidiary capital may likewise be disallowed as a deduction. Only the franchise tax actualy paid during the base year is deductible. All the deductions reduce business income. The total business income and investment income is adjusted for net capital losses, the difference being entire net income.

The analysis will require a computation of the ratio of investment income to total business and investment income. This ratio will determine the right of a taxpayer to use the separate allocations for investment income and business income.

The return will require an analysis and computation of capital. This is done by setting forth in a separate schedule the average fair market value of all assets. The form will make provision for recording also book values at the beginning and end of the year. Liabilities are also required to be set forth. In fact, the list of assets and liabilities so far as the book values are concerned will be virtualy a copy of Schedule L of the Federal tax return.

The analysis of capital requires the breakdown of capital into subsidiary captial, investment capital and busines capital. Total capital would be total assets less liabilities with original maturities of less than one year or payable on demand. From this is deducted that part of the capital which represents subsidiary capital. This is computed separately in another schedule to be discussed later. A further deduction is then made for investment capital which is likewise separately computed in another schedule. The difference is business capital. (See Schedule A).

Subsidiary capital is compiled in a separate schedule. All subsidiary investments are listed separately at the average fair market value during the year reduced for the fraction of the year that the securities were held. These values are then reduced for that portion which represents the amount allocated outside of New York State. The subsidiary's allocation percentage is used for this purpose. The total value allocated to New York is then divided by the total unallocated average fair market value of all subsidiary investments to obtain the final subsidiary allocation percentage.

Since a portion of cash and Federal obligations may be treated as subsidiary capital, these are now added to total unallocated subsidiary capital and from this total is deducted current liabilities attribu-

table to subsidiary capital. The difference is subsidiary captial to which is applied the subsidiary allocation percentage to determine the amount of subsidiary capital taxable in New York. (See Schedule B).

The above procedure is followed also in a separate schedule to determine investment capital. All corporate stock investments and governmental secrutiies except United States securities are listed at the average fair market value for the year, reduced for the fraction of the year such securities were held. These separate values are reduced for that portion which represents the amount allocated outside of New York State. The issuing corporation's allocation percentage is used for this purpose except that New York State bonds are allocated 100% to New York and bonds of other States are allocated 100% outside of New York. The total value allocated to New York is then divided by the total unallocated average fair market value of all investment stock and securities to obtain the final investment allocation percentage to be used for the one-mill tax or the tax based on income.

To the total value of investments is then added United States obligations and cash capital which may optionaly be treated as investment capital. These items will be allocated to New York on the basis of the investment allocation percentage as determined above. The final total is investment capital. (See Schedule C).

The allocation of business income or business capital is based upon the three factors of property, receipts, and payrolls. The schedule will make provision for determining the percentage of the average value of real estate and tangible personal property owned in New York State to the average value of such property owned everywhere. That is the first percentage.

The second factor, receipts, requiries an enumeration of the following items:

1. Receipts from sales, in the regular course of business, of tangible personal property located in New York State at the time of the receipt of orders, or appropriation to the orders, irrespective of where the orders were received or accepted.
2. Receipts from sales of tangible personal property not located at any permanent or continuous place of business outside New York State at the time of the receipt of the order, or appropriation to the order, if the orders were received or accepted in New York State.
3. Receipts from services.
4. Receipts from rentals of property situated in New York State.
5. Receipts from royalties for the use in New York State of patents and copyrights.
6. All other business receipts earned in New York State.

The total of the above items will be the numerator of the fraction determining the second percentage. The denominator is total receipts within and without New York State from all sales, services, rentals, royalties and other business transactions.

The third percentage is the ratio of wages, salaries and other compensation of employees, except general executive salaries for all services in New York State, to such compensation within and without New York State.

The total of all three percentages is then added and divided by three to obtain the business allocation percentage.

The next necessary computation is the combined allocation percentage for business income and investment income. This is determined

as follows: The business allocation percentage obtained above is applied to (multiplied by) business income which has already been determined. The investment allocation percentage is applied to (multiplied by) investment income. Both products are added. The total is divided by the total unallocated business and investment income. The result is the combined allocation percentage to be applied to entire net taxable income. (See Schedule D).

The next schedule is the calculation of the tax. The first computation is the New York entire net income multiplied by the combined allocation percentage. The second computation is made to determine whether the salary elimination basis is applicable. It is therefore entire net income plus total salaries and other compensation of officers and stockholders owning in excess of 5% of issued capital stock, less a specific exemption of $5,000; 30% of the balance is then multiplied by the combined allocation percentage. The third computation is made to determine whether the one-mill tax is applicable. For this computation New York business capital is multiplied by the business allocation percentage previously determined. New York investment capital is multiplied by the investment allocations percentage previously determined, and both products are added.

The final computation is for the tax on New York subsidiary capital.

SCHEDULE A—ANALYSIS OF CAPITAL		
1. **Total Capital** (Balance Sheet Schedule)	$	
2. **Subsidiary Capital** (Schedule B Item 3)		
3. **Business and Investment Capital** (Item 1 + 2)	$	
4. **Investment Capital** (Schedule C Item 5)		
5. **Business Capital** (Item 3 + 4)	$	

SCHEDULE B—SUBSIDIARY CAPITAL AND ALLOCATION						
(a) Description of Investment in Subsidiary	(b) No. of Shares—Am't of Bonds	(c) Average Fair Market Value		(d) Subsidiary Allocation %	(e) Value Allocated to N Y State	
				%		
1. Totals		$		xxxxxxx	$	
2. Less Current Liabilities Attributable to Subsidiary Capital				xxxxxxx	xxxxxxxxxx	xx
3. Subsidiary Capital (Item 1c minus 2c)		$		xxxxxxxxxx	xxxxxxxx	xx
4. Subsidiary Allocation % (Item 1e ÷ Item 1c)				%	xxxxxxxxx	xx
5. N. Y. Subsidiary Capital (Item 3c x % Item 4d)						

SCHEDULE C—INVESTMENT CAPITAL AND ALLOCATION						
(a) Description of Investments	(b) No. of Shares—Am't of Bonds	(c) Average Fair Market Value		(d) Issuer's Allocation %	(e) Value Allocated N Y State Col. d x Col. C	
				%		
1. Totals		$		xxxxxxxxxx	$	
2. Investment Allocation % (Item 1e ÷ 1c)		xxxxxxxxxx	xx	%	xxxxxxxxxx	xx
3. Obligations of U. S.		$		xxxxxxxxxx	xxxxxxxxxx	xx
4. Cash (Optional)				xxxxxxxx	xxxxxxxxxx	xx
5. Investment Capital (Total of Items 1c, 3c and 4c.)		$		xxxxxxxxxx	xxxxxxxxxx	xx

SCHEDULE D—COMBINED ALLOCATION %		
1. **Business Income** (From Analysis of Income Schedule x Bus. Alloc. %)	$	
2. **Investment Income** (From Analysis of Income Schedule x % Schedule C Item 2)		
3. **Total**	$	
4. Total **Business & Investment Income** (From Schedule of Gross Income)	$	
5. **Combined Allocation %** (Item 3 ÷ 4)		

STATE SOCIETY ACTIVITIES

Calendar of Events

January 5—Friday—7 P. M.—Tax lecture and forum session. Location: Engineering Auditorium, 29 West 39th Street, New York. Subject: **Tax Aspects of Wage and Salary Stabilization.** Speaker: H. Kenneth Marks.

January 8—Monday—Regular meeting of the Board of Directors.

January 8—Monday—7:30 P. M.—Regular meeting of the Society. Location: Waldorf-Astoria Hotel, Lexington Avenue & 49th Street, New York. Subject: To be announced.

January 16—Tuesday—7 P. M.—Special technical meeting—Location: Engineering Auditorium, 29 West 39th Street, New York. Subject: Wage and Salary Stabilization. Speaker: Ben Greenberg.

No February Meeting

As provided in the By-Laws of the Society, the Board of Directors has again dispensed with the February Society meeting because of the fact that members will be under extra heavy pressure during that month.

The next regular meeting of the Society is scheduled for March 19, 1945.

Board Censures Member

At the meeting of the Board of Directors of the Society held November 27, 1944, a hearing was held on a complaint filed with the Society charging a member with professional misconduct. The member appeared in person at the hearing and there orally presented his answer and defense to the complaint. The Board of Directors, immediately upon the conclusion of the hearing, gave full consideration to the evidence presented in support of the complaint and in answer and defense thereto, and

Resolved: that the Board of Directors of the New York State Society of Certified Public Accountants hereby censures the member of the Society for conduct discreditable to the profession of public accountancy, in that the said member received sums of money from the clients of a firm of which he was then a partner without disclosing to all of the partners of his firm the fact that he had received said sums of money; and that such a duty of disclosure rested upon him whether such sums of money were either fees or gratuities.

The aforesaid censure of the conduct of this member received the affirmative votes of twelve of the members of the Board present at the hearing, constituting a majority of the entire Board of Directors of the Society, and four of the members of the Board present at the hearing dissented from the said vote of censure on the sole ground that they favored disciplinary action more severe than censure.

Accounting Course

A course on Current Problems in Accounting for Lawyers will be conducted by the Practising Law Institute in New York City this spring as part of its 29th series of lectures. The New York State Society of Certified Public Accountants and the American Institute of Accountants are cooperating in making these practical talks available for lawyers and

accountants in New York City and environs.

This course, which will tentatively begin on Thursday, March 2, and continue one night a week for a total of 12 weeks, will be conducted at the building of the New York County Lawyers' Association, 14 Vesey Street, New York City. It will consist of 12 lectures tentatively selected as follows: Significance of the Balance Sheet—What is Book Value?; The Profit & Loss Statement—The Accountant's Concept of Profit; Financial Statements from the Viewpoint of the Credit Man and the Financial Analyst; Partnerships and Closed Corporations; Distribution of Profits; Valuation of Business Entities Through Use of Accounting Data; Accounting Principles in Renegotiation and Termination of War Contracts; Accounting Principles in Relation to Tax Problems; Effect of SEC and Treasury Department Policies on Accounting Principles and Procedures; Proof of Facts Through Accounting Data—Accountant's Expert Testimony; What the Auditing Process Actually Is; and Accounting Principles in Consolidations, Reorganizations and Mergers.

Among the men who have accepted invitations to speak are: Carman G. Blough, Director of Research, American Institute of Accountants; Eric A. Camman, of Peat, Marwick, Mitchell & Co.; A. S. Fedde, of Fedde & Company; Benjamin Graham, President of Graham-Newman Corporation; Carlos L. Israels, assistant general counsel to trustees of Associated Gas & Electric Corp.; Joseph J. Klein of Klein, Hinds & Finke; Edward A. Kracke, of Haskins & Sells; J. Arthur Marvin, of F. W. Lafrentz & Co.; Christian Oehler, of Oehler & Sanford; Walter A. Staub, Lybrand, Ross Bros. & Montgomery; C. Oliver Wellington, of Scoville, Wellington & Co.; and William W. Werntz, Chief Accountant for the SEC. Other prominent lawyers and accountants are also expected to participate.

According to Henry A. Horne, President of the Society, this lecture series will constitute an educational milestone in this city. The talks will be concise and practical and should appeal to accountants and lawyers alike. They are designed to promote a better understanding of the problems of each profession involved in everyday matters in which lawyers and accountants work side-by-side.

The cost of the 12 lectures is $20. Further information may be obtained by writing to the Practising Law Institute, 92 Liberty Street, New York 6, N. Y.

Frank Berkeley Austin, a member of the Society since March, 1938, passed away January 3, 1945.

Lieutenant William L. Combrinck-Graham was killed in a flying accident in France on December 5, 1944. Lieutenant Combrinck - Graham, who served with the Royal Canadian Air Force and later with the United States Army Air Forces, was thirty-one years old. He had been a member of the Society since December, 1940.

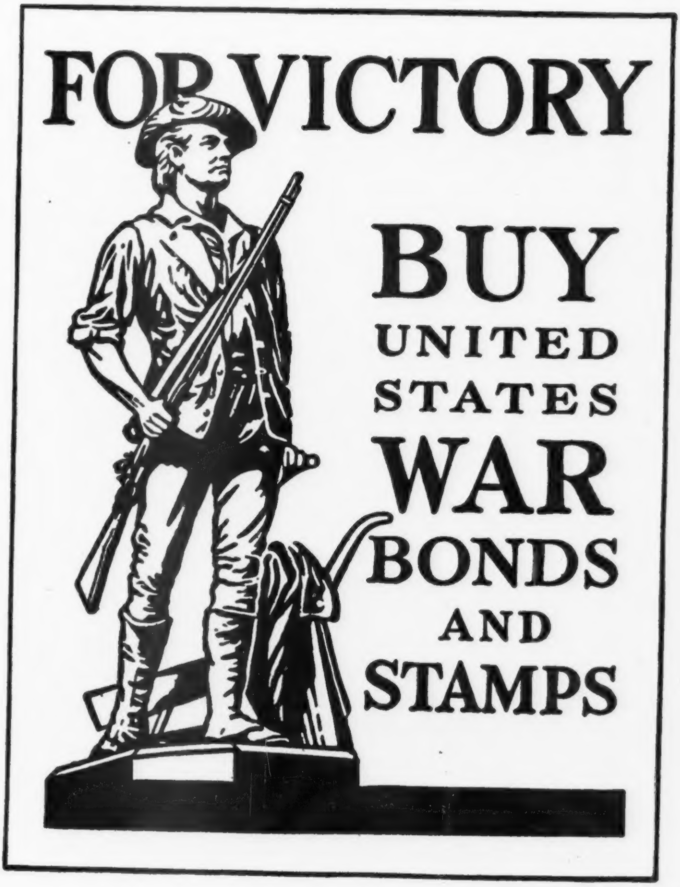
Word has just been received that Seymour J. Levenson, a member of the Society since November, 1924, passed away in June, 1944.

George J. Matteson, an associate member of the Society since November, 1943, passed away December 5, 1944.

Jessie J. Stecker, a member of the Society since March, 1934, passed away December 19, 1944.

Emanuel R. Wilhelm, a member of the Society since September, 1943, passed away October 1, 1944.

The Society has suffered a great loss in the passing of these valued and esteemed members.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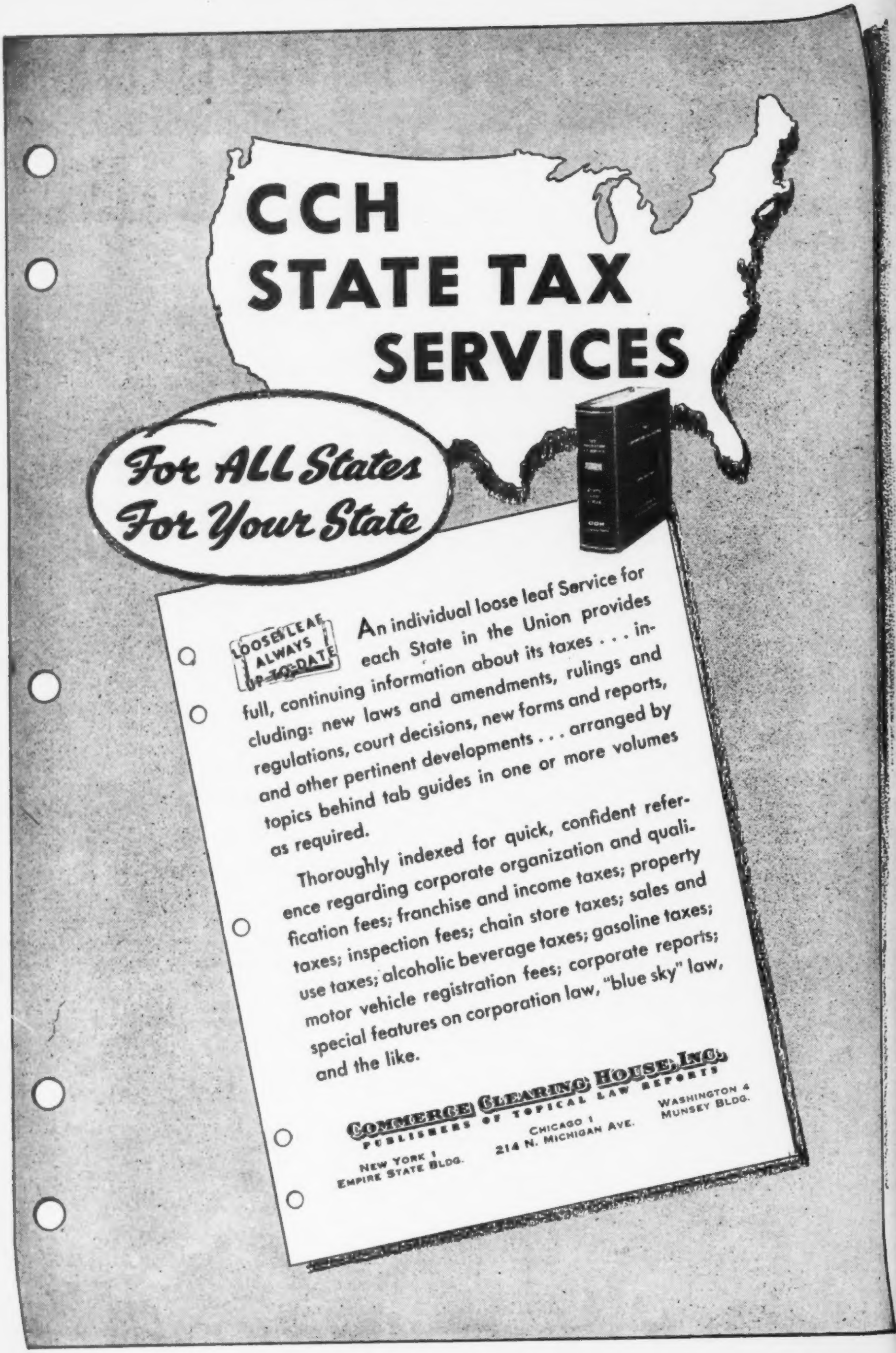

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